Statement of
A. Thomas Connolly
Vice President, Finance and Administration
M/A Com, Inc.

before the

Subcommittee on Investigations
Committee on Armed Services
United States House of Representatives

September 29, 1983

Summary

- The central thrust of H.R.2545 is to promote effective competition among suppliers of goods and services to the U.S. Government assuring, therefore, that the costs of such goods and services will be determined through the operation of a free and open marketplace.

- We are confident that the mutual efforts of both the House and the Senate will produce meaningful legislation that will promote and optimize the use of America's free enterprise system and also protect the interest of the American taxpayer.

- The certification threshold primarily affects only small government contractors, since the bulk of large contractors' business involves contracts well in excess of $500,000 and since for all practical purposes these large contractors already are fully staffed and resourced to work with certification requirements.

- AEA feels that the provisions of H.R.2545 are more in consonance with today's economic realities and that they optimize the use and focus of the procurement process and the human resources utilized in that process.

- It must be understood that the U.S. Government must not only bear the cost of its own human resources it must also bear the cost of industry personnel engaged in the procurement process.

- The principal determinant of price is and ought to be the inherent desire to sustain a fruitful and profitable relationship with a good customer over the long term and the willingness of reasonable and competent people to negotiate in good faith.

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I am appearing before you today on behalf of the American Electronics Association. AEA now represents over 2,300 member companies nationwide, and over 450 financial, legal and accounting organizations which participate as associate members. AEA encompasses all segments of the electronics industry including manufacturers and suppliers of computers and peripherals, semiconductors and other components, telecommunications equipment, defense systems and products, instruments, software, research, and office systems. The AEA membership includes companies of all sizes from "start-ups" to the largest companies in the industry, but the largest number (80%) are small companies employing fewer than 200 employees. Together our companies account for 63% of the worldwide sales of the U.S. based electronics industry.

The central thrust of H.R.2545 is to promote effective competition among suppliers of goods and services to the United States Government assuring, therefore, that the costs of such goods and services will be determined through the operation of a free and open marketplace. Our faith in and our reliance upon such a marketplace has made the American economy the strongest the world has ever seen.

The position of the American Electronics Association in this matter is a very simple one - we support open and intensive competition. We feel that such competition should be the principal determinant of price. Not only does AEA support any legislative effort on the part of Congress to achieve that end, it is willing to participate in the legislative process in any way that this Committee sees fit.

Essentially the same proposition addressed in H.R.2545 is being considered in a constructive way in the United States Senate in S.338. We are confident that the mutual efforts of both the House and the Senate will produce meaningful legislation that will promote and optimize the use of America's free enterprise system and also protect the interests of the American taxpayer. The latter is inexorably dependent upon the former.

I want to point out today that the legislation under consideration in the Senate (S.338) differs from that of H.R.2545 in certain important ways. Prior to the enactment of law these differences will have to be contemplated, debated and resolved and I am confident that a responsible solution will be reached.

One of the provisions of H.R.2545 which distinguishes it from its Senate counterpart permits agency heads to use other than competitive procedures when "the contract to be awarded results from acceptance of an unsolicited proposal that demonstrates a unique or innovative concept". The Senate bill does not contain such a provision. However, AEA feels that where a company, particularly one in the high technology industry, devotes its own time and resources to the understanding of a problem and then submits an unsolicited proposal offering the government a unique solution to that problem, then that company should be allowed the opportunity to negotiate a sole source contract.

Another one of the differences that has prompted much comment and debate is the provision in each bill that would require certification of cost or pricing data in those instances where cost or pricing data is required at all.

I would like to focus the rest of my statement on this provision. In essence, H.R.2545 would require certification of costs or pricing data whenever adequate price competition does not exist and the instant procurement would result in a contract for an amount in excess of $500,000. That $500,000 threshold is consistent with existing law (as amended by Congress in the FY 82 Defense Authorizations). S.338 would reduce the certification requirement to $100,000.

AEA believes that certification of cost or pricing data is warranted if not essential in those procurement instances where adequate price competition is not operative.

While in substantial accord with the general provisions of both H.R.2545 and S.338, AEA feels that the provisions of H.R.2545 are more in consonance with today's economic realities and that they optimize the use and focus of the procurement process and the human resources utilized in that process.

The requirement for certification of cost or pricing data was established in 1962 at $100,000. If one were to discount today's dollar at 8% per annum for 21 years one would see that the certification provisions of H.R.2545 would translate to approximately $99,300 1962 dollars. Therefore, H.R.2545 has placed the certification provisions at approximately the same threshold as did Public Law 87-653 some 21 years ago. Stated differently, to restore the certification threshold to the 1962 level would be the equivalent of having established the original threshold at about $20,000. If Congress felt that the 1962 certification requirements were practical and reasonable, I fail to see that anything has happened during the ensuing 21 years that would warrant this provision effectively to increase by a factor of five. S.338 does essentially that.

I should note that the issue involving the certification threshold is not of any particular concern or interest to most major defense contractors. Indeed I would be surprised if it

were. After all, the procurement actions under $100,000 or $500,000 for that matter would be of no material financial consequence to major contractors. Testimony by Harvey Gordon of DOD's Acquisition Management office, has stated that over the past two fiscal years, 13,752 DOD procurement actions out of a total of 65,666 DOD actions involved contracts over $500,000. However, these 13,752 actions (21% of the total) accounted for over 92% of expenditures. Thus, it is the remaining 8% of expenditures (79% of total actions) which falls under the $500,000 threshold and which is of particular importance to smaller defense contractors.

Further, for all practical purposes, large contractors are already fully staffed and resourced to work with Public Law 87-653 regardless of the certification threshold.

AEA believes that the smaller prime contractor and sub-contractor is affected by the lower threshold as is the U.S. Government itself. There are costs borne by the U.S. Government that are directly associated with the lower threshold. While there are those who hold that savings will accrue to the U.S. Government as a direct result of lowering the certification threshold, my experiences, and those of other AEA members, lead to an opposite conclusion. In short, a good portion of these so-called "cost savings" are more imagined than real. In this context I should like to present the following notions for your consideration:

(a) Estimated hourly cost of all the human resources utilized in the procurement process has more than tripled since 1962. If the certification threshold is restored to the 1962 level it simply means that labor costs for both government and industry personnel relative to that threshold is about 3 1/2 times higher per procurement dollar. To the extent that the threshold itself impacts the utilization of manpower that utilization will have been greatly impacted from a cost point of view.

(b) It must be understood that the U.S. Government must not only bear the cost of its own human resources it must also bear the cost of industry personnel engaged in the procurement process. To this extent, smaller contractors and subcontractors will need to engage more personnel and even greater costs if a lower threshold is imposed.

(c) There is a view (and we feel a faulty one) that suggests that it is principally the certification and/or audit of cost or pricing data that results in significant "cost savings" to the U.S. Government. In my opinion there is something a lot more important and a lot more basic going on during contract formulation. Notwithstanding the provisions of the Defense Acquisition Regulations (DAR), the entire procurement process eventually comes down to a businessman dealing with a valued customer. His desire to satisfy his customer's needs and, as a result, enjoy a long relationship and repeat business with his customer transcend any concerns about certification of data, audits and so forth. Simply put, there are more powerful forces at work than the Truth in Negotiation Act during the procurement process. The influence of certification on the transaction of business in its simplest form has been exaggerated.

(d) Some proponents of a lower certification threshold cite "cost savings" to the government resulting from pre-award financial audits of cost proposals. However, the pre-award financial audit of a cost proposal and the resultant recommendation considers all data, factual and estimated. The so-called, "cost savings" have little if anything to do with defective data per se. Rather, the audit recommendation is merely a difference of opinion between the auditor and the contractor. Sometimes that difference is "real"; other times it is inspired by the need to "find something". We are, after all, dealing with human nature here. It is conceivable that a perfectly good contract pricing proposal could be questioned more severely than a terribly weak and erroneous one. I have seen it happen. But the point is that it is not necessarily <u>defective</u>

data that forms the basis of audit recommendations. Further, it must be understood that all audit recommendations do not and should not survive the ensuing negotiations. It is important to remember that while many government auditors are fine, earnest and competent men and women, they are not always right. Consequently, their findings are sometimes (and rightly so) refuted and overruled. But that is what the negotiation process is all about. It affords both sides an opportunity to debate the issues and reach a reasonable accommodation.

Finally, a personal note. I have been engaged in cost and pricing activity on virtually a daily basis for over 25 years. In all that time I cannot recall a single contract pricing proposal where its direct cost of the product that were impacted by as much as one dollar because of the need to certify cost or pricing data. However, indirect costs are impacted by staff requirements to support the procurement process. Also I cannot recall a single negotiation where the final price was concluded on any other basis than it would have been had the certification requirements not existed. The principal determinant of price is and ought to be the inherent desire to sustain a fruitful and profitable relationship with a good customer over the long term and the willingness of reasonable and competent people to negotiate in good faith. In substance, then, it is the negotiation process itself not the audit and certification processes that establish price.

Thank you, Mr. Chairman and members of the committee for your attention. I will be pleased to discuss this issue with you either now or in the future and to answer any questions you may have. Thank you once again for the opportunity to be with you today.